

EXECUTIVE SECRETARIAT
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Remarks

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amy *100*

Executive Secretary

8 March 85

Date

3637 (10-81)

CABINET AFFAIRS STAFFING MEMORANDUM

Date: 3/4/85 Number: ----- Due By: -----

Subject: Cabinet Council on Economic Affairs Minutes

Executive Registry

85-699/1

January 31 and February 20, 1985

ALL CABINET MEMBERS	Action	FYI		Action	FYI
Vice President	<input type="checkbox"/>	<input checked="" type="checkbox"/>	CEA	<input type="checkbox"/>	<input checked="" type="checkbox"/>
State	<input type="checkbox"/>	<input type="checkbox"/>	CEQ	<input type="checkbox"/>	<input type="checkbox"/>
Treasury	<input type="checkbox"/>	<input type="checkbox"/>	OSTP	<input type="checkbox"/>	<input type="checkbox"/>
Defense	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Justice	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Interior	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Agriculture	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Commerce	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Labor	<input type="checkbox"/>	<input type="checkbox"/>	Deaver	<input type="checkbox"/>	<input checked="" type="checkbox"/>
HHS	<input type="checkbox"/>	<input type="checkbox"/>	McFarlane	<input type="checkbox"/>	<input checked="" type="checkbox"/>
HUD	<input type="checkbox"/>	<input type="checkbox"/>	Svahn	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Transportation	<input type="checkbox"/>	<input type="checkbox"/>	Chew (For WH Staffing)	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Energy	<input type="checkbox"/>	<input type="checkbox"/>	Chapman	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Education	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Counsellor	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
OMB	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
CIA	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
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USTR	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Chief of Staff	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
GSA	<input type="checkbox"/>	<input type="checkbox"/>	Executive Secretary for:		
EPA	<input type="checkbox"/>	<input type="checkbox"/>	CCCT	<input type="checkbox"/>	<input checked="" type="checkbox"/>
NASA	<input type="checkbox"/>	<input type="checkbox"/>	CCEA	<input type="checkbox"/>	<input checked="" type="checkbox"/>
OPM	<input type="checkbox"/>	<input type="checkbox"/>	CCFA	<input type="checkbox"/>	<input checked="" type="checkbox"/>
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SBA	<input type="checkbox"/>	<input type="checkbox"/>	CCLP	<input type="checkbox"/>	<input checked="" type="checkbox"/>
			CCMA	<input type="checkbox"/>	<input checked="" type="checkbox"/>
			CCNRE	<input type="checkbox"/>	<input checked="" type="checkbox"/>

REMARKS:

Attached for your information are the minutes of the January 31 and February 20, 1985 meetings of the Cabinet Council on Economic Affairs.

RETURN TO:

☐ Alfred H. Kingon
Cabinet Secretary
456-2823
(Ground Floor, West Wing)

☐ Don Clarey
☒ Tom Gibson
☐ Larry Herbolsheimer

Associate Director
Office of Cabinet Affairs
456-2800 (Room 129, OE08)

DCI
EXEC
REG

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

January 31, 1985
2:00 p.m.
Roosevelt Room

Attendees: The Vice President, Messrs. Regan, Block, Baldrige, Pierce, Stockman, Brock, Ford, Niskanen, Svahn, Oglesby, Speakes, Verstandig, Porter, Wright, Burnley, Boggs, Healey, Naylor, Baroody, Breeden, Donatelli, Draper, Gibson, Keel, Khedouri, and Li, and Ms. Risque.

1. Economic Impact of Farm Credit Conditions

Secretary Block and Mr. Stockman presented a proposal that would initiate an eight-point emergency Federal credit relief program in return for congressional support of a market-oriented 1985 Farm Bill. The credit relief program would include:

1. Establishing a Farm Credit Coordinating Group to coordinate the activities of the various Federal and financial regulatory agencies with responsibilities for dealing with agricultural lending institutions;
2. Modifying regulations for the Presidential Initiative to allow an interest writedown option with a maximum 90 percent guarantee of the equivalent principal writedown level;
3. Providing emergency 90 percent guaranteed operating loans to eligible producers previously served by failed lending institutions;
4. Establishing "special action teams" composed of from 5 to 100 trained employees to assist in reestablishing necessary operating credit for qualified operators in areas where lending institutions have been liquidated;
5. Having the Department of the Treasury work with bank regulators to implement a policy of avoiding supervisory actions that may discourage banks from exercising forbearance with farmers and small business borrowers experiencing temporary difficulties in meeting their debt service obligations;

Minutes
Cabinet Council on Economic Affairs
January 31, 1985
Page two

6. Easing current restrictions to recruiting members of support teams to work with lenders on the Presidential Initiative;
7. Expanding and strengthening "credit hot lines" in various States to provide financial information and advice to troubled operators; and
8. Actively soliciting State governments and lenders to make available staff members to assist in the timely processing of loan applications.

In return for initiating this emergency program, the Administration would seek support for long-term reforms of farm programs. This reform plan would include:

1. Programs based on general principles of market-oriented agriculture;
2. Phase-down of price support levels beginning in the 1986 crop-year;
3. Non-recourse feature of price support loans limited to a maximum of \$200,000 per producer;
4. Multi-year phase-out of target price and deficiency payments;
5. No paid diversions, farmer-owned reserves, or other subsidized warehousing systems;
6. Reduction of dairy price supports to market-related levels over several years;
7. A 5 percent origination fee on the CCC Export Credit Program if applied to all other Federal guarantee programs; and
8. No new farm price support, credit, or export subsidy programs.

The Council discussed the membership of the Farm Credit Coordinating Group, noting that the Administration should discuss with the Federal Reserve about how it wishes to be involved.

Minutes
Cabinet Council on Economic Affairs
January 31, 1985
Page three

Council members noted that the long-term reforms of agricultural programs should be consistent across all crop products, otherwise it would be difficult to maintain support for overall reforms.

The Council also discussed how the interest writedown option would affect the cash flow position of farmers and the earnings position of banks. It was noted that the cash flow position of farmers would be the same under the interest writedown option as under the principal writedown option. However, because the principal writedown would require the banks to take the entire loss in the current year, writing down the principal is less attractive to banks.

The Vice President noted Secretary Regan's success as Chairman Pro Tempore of the Cabinet Council on Economic Affairs over the last four years and expressed on behalf of other Council members his appreciation for Secretary Regan's leadership.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

February 20, 1985
10:00 a.m.
Roosevelt Room

Attendees: Messrs. Baker, Baldrige, Ford, Svahn, Darman, McManus, Verstandig, Niskanen, Kingon, Lighthizer, Porter, Naylor, Healey, Khedouri, Breeden, Donatelli, Gibson, Ginsburg, Grundfest, Herbolsheimer, Lilly, McMin, Robinson, Shepherd, and Li, Ms. McLaughlin, Ms. Risque, and Ms. Constable.

1. Report of the Working Group on Farm Credit Conditions

Mr. Khedouri reviewed current farm credit legislative proposals. The most significant legislative proposals have three principal features.

1. They would increase the loan guarantee authority of the Farmers Home Administration (FmHA). The proposed increases range from \$1.7 billion to \$3.3 billion.
2. They would eliminate certain conditions for loan guarantees. Currently, the September 1984 debt restructuring initiative as amended by recent measures provides guarantees of loans if either the principal or interest is written down. Many proposals would eliminate these conditions.
3. They would advance crop loans for which the farmer would ordinarily be eligible after harvest. Despite claims that this proposal would not increase budget outlays since funds are already authorized, the proposal would increase outlays because of the greater probability of the government taking over stocks and the increased participation it would stimulate in the price support program.

Mr. Healey reviewed recent actions of the bank regulatory agencies. The Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve System, and the Farm Credit Administration (FCA) will issue a joint statement reinforcing their policy of encouraging banks and associations to work with farmers and small business borrowers experiencing temporary difficulties in servicing their debt. The purpose is to ensure that

Minutes
Cabinet Council on Economic Affairs
February 20, 1985
Page two

examiners treat lenders consistently and with forbearance, provided the institutions' practices are generally consistent with safety and soundness considerations. The statement clarifies that a loan will be considered satisfactory if payments are being made, even if surrounding land values have fallen significantly.

Mr. Naylor reviewed the financial condition of the Farm Credit System. While there are some liquidity problems, the overall system is fundamentally sound. He discussed the capital position of FCS institutions.

The Council unanimously agreed that the problem is the liquidity, rather than the fundamental economic condition, of the farm credit system. It noted that the liquidity problem can be addressed through regulation, which obviates the need for legislation. The Council reviewed the likely legislative activity over the next several weeks.

The Council discussed the current debt-restructuring program. It reviewed how the bank regulatory agencies are treating lenders and what criteria they are using. Council members noted the implication of efforts to remove nonperforming loans from the rate base of lenders.

The Council recommended that the President and the Administration continue to oppose any additional legislation that would expand further Federal farm loan or loan guarantee programs. Administration officials will encourage the States in the upcoming National Governors' Association meetings to take actions to complement Federal actions, for example, by removing restrictions against investment in farmland which contribute to the decline in land values.

CABINET AFFAIRS STAFFING MEMORANDUM

Date: 2/19/85 Number: 169139 Due By: -----

Subject: Cabinet Council on Economic Affairs Meeting - February 20

Roosevelt Room Topic: Farm Credit

10:00 A.M.

Corporate Takeovers

ALL CABINET MEMBERS	Action	FYI		Action	FYI
Vice President	<input checked="" type="checkbox"/>	<input type="checkbox"/>	CEA	<input checked="" type="checkbox"/>	<input type="checkbox"/>
State	<input checked="" type="checkbox"/>	<input type="checkbox"/>	CEQ	<input type="checkbox"/>	<input type="checkbox"/>
Treasury	<input checked="" type="checkbox"/>	<input type="checkbox"/>	OSTP	<input type="checkbox"/>	<input type="checkbox"/>
Defense	<input checked="" type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Justice	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Interior	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Agriculture	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Deaver	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Commerce	<input checked="" type="checkbox"/>	<input type="checkbox"/>	McFarlane	<input type="checkbox"/>	<input type="checkbox"/>
Labor	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Svahn	<input checked="" type="checkbox"/>	<input type="checkbox"/>
HHS	<input type="checkbox"/>	<input checked="" type="checkbox"/>	Chew (For WH Staffing)	<input type="checkbox"/>	<input type="checkbox"/>
HUD	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Chapman	<input type="checkbox"/>	<input type="checkbox"/>
Transportation	<input checked="" type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
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Counsellor	<input checked="" type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
OMB	<input checked="" type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
CIA	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
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USTR	<input checked="" type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Chief of Staff	<input type="checkbox"/>	<input type="checkbox"/>	Executive Secretary for:		
GSA	<input type="checkbox"/>	<input type="checkbox"/>	CCCT	<input checked="" type="checkbox"/>	<input type="checkbox"/>
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SBA	<input type="checkbox"/>	<input type="checkbox"/>	CCMA	<input type="checkbox"/>	<input type="checkbox"/>
			CCNRE	<input type="checkbox"/>	<input type="checkbox"/>

REMARKS:

There will be a Meeting of the Cabinet Council on Economic Affairs on Wednesday, February 20, 1985, at 10:00 A.M. in the Roosevelt Room.

The agenda and background paper are attached.

RETURN TO:

☐ Alfred H. Kingon
Cabinet Secretary
456-2823
(Ground Floor, West Wing)

☐ Don Clarey
☒ Tom Gibson
☐ Larry Herbolsheimer

Associate Director
Office of Cabinet Affairs
456-2800 (Room 129, OEOB)

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THE WHITE HOUSE

WASHINGTON

February 15, 1985

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: ROGER B. PORTER *RBP*

SUBJECT: Agenda and Paper for the February 20 Meeting

The agenda and paper for the February 20 meeting of the Cabinet Council on Economic Affairs are attached. The meeting is scheduled for 10:00 a.m. in the Roosevelt Room.

The Council is scheduled to consider two agenda items: farm credit conditions and corporate takeovers. The Working Group on Farm Credit has met several times since the last Cabinet Council meeting on this subject. Its report will include an assessment of legislative developments, a review of the actions of the bank regulatory agencies, and an analysis of the condition of the Farm Credit System. No papers will be distributed in advance of the meeting.

The second agenda item is corporate takeover legislation. The Council last considered corporate takeovers at its meeting on July 24, 1984, when it established an interagency working group to determine the extent of the problem of abuses in tender offers and what approach would best address potential abuses. The Working Group has held a number of meetings examining the data and developing an Administration position on possible corporate takeover legislation. A package of materials from Doug Ginsburg, chairman of the Working Group on Corporate Takeovers, was distributed to Council members on January 22. A "Proposed Administration Position on Corporate Takeovers" incorporating the latest revisions is attached.

Attachments

THE WHITE HOUSE

WASHINGTON

CABINET COUNCIL ON ECONOMIC AFFAIRS

February 20, 1985

10:00 a.m.

Roosevelt Room

AGENDA

1. Farm Credit Conditions (CM#515)
2. Report of the Working Group on Corporate Takeovers (CM#491)

PROPOSED ADMINISTRATION POSITION
CORPORATE TAKEOVERS

- I. Corporate takeovers perform several beneficial functions and are generally good for the economy.
- II. The Williams Act represents a compromise between the desire to afford target shareholders and managements adequate disclosure and a reasonable period of time in which to evaluate offers, and the needs of the competitive markets in securities and in corporate control to operate with a minimum of government regulatory interference. We have not seen sufficient evidence that the existing provisions of the Williams Act are inadequate to achieve their purpose.
- III. Various limitations on bidder activities have been proposed, but a need for additional restrictions on bidders has not been demonstrated.
- IV. Target company shareholders need and have protection from abuses by target managements in conjunction with contests for corporate control.
- V. State law, enforceable in the courts, governs the permissible terms of corporate charters, management contracts, and managers' and directors' fiduciary obligations, each of which may serve to check management abuses. From existing state statutes and decisions of state and Federal courts, however, it is unclear whether state law is adequate to protect target company shareholders from abuses by target management. As new defensive tactics evolve, moreover, existing protections may prove inadequate.
- VI. The balance between management's need to act expeditiously in the interest of the corporation and the shareholder's right to call that action into account should be resolved at the level closest to the problem and the relevant facts--by the corporation, its owners, and managers in the first instance; by state law, if necessary; and, by Federal law only as a last resort. If the states and the courts fail to check abuses by target managements and if that causes a serious market failure of national dimensions, then the Federal Government should consider taking appropriate steps to curb the potential for abuse. Otherwise, the federal government should take no step towards the establishment of Federal corporation law to govern relationships between shareholders and managers.

- VII. While matters of corporation law have traditionally been the subject of state rather than Federal jurisdiction, the Federal Government should play an informational role by making public the best information about critical issues that shareholders are likely to face in corporate change of control contests.
- VIII. The Federal Government should also carefully consider the unintended effects that other Federal policy decisions may have on merger and acquisition activity. To the extent that these Federal decisions encourage more or less merger and acquisition activity than otherwise would have taken place in a free market, resources may be misallocated.

WASHINGTON

Executive Registry

85- 561

CABINET AFFAIRS STAFFING MEMORANDUM

Date: 1/31/85 Number: 169129CA Due By:

Subject: Cabinet Council on Economic Affairs Planning Meeting - 1/31/85

2:00 P.M. - Roosevelt Room TOPICS: Farm Credit Conditions
Ex-Im Bank Interest Subsidies

ALL CABINET MEMBERS	Action	FYI		Action	FYI
Vice President	<input checked="" type="checkbox"/>	<input type="checkbox"/>	CEA	<input checked="" type="checkbox"/>	<input type="checkbox"/>
State	<input checked="" type="checkbox"/>	<input type="checkbox"/>	CEQ	<input type="checkbox"/>	<input type="checkbox"/>
Treasury	<input checked="" type="checkbox"/>	<input type="checkbox"/>	OSTP	<input type="checkbox"/>	<input type="checkbox"/>
Defense	<input checked="" type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Attorney General	<input checked="" type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Interior	<input checked="" type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Agriculture	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Baker	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Commerce	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Deaver	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Labor	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Darman (For WH Staffing)	<input checked="" type="checkbox"/>	<input type="checkbox"/>
HHS	<input checked="" type="checkbox"/>	<input type="checkbox"/>	McFarlane	<input checked="" type="checkbox"/>	<input type="checkbox"/>
HUD	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Svahn	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Transportation	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Chapman	<input type="checkbox"/>	<input type="checkbox"/>
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Counsellor	<input checked="" type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
OMB	<input checked="" type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
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USTR	<input checked="" type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
GSA	<input type="checkbox"/>	<input type="checkbox"/>	Executive Secretary for:		
EPA	<input type="checkbox"/>	<input type="checkbox"/>	CCCT	<input checked="" type="checkbox"/>	<input type="checkbox"/>
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SBA	<input type="checkbox"/>	<input type="checkbox"/>	CCLP	<input type="checkbox"/>	<input type="checkbox"/>
			CCMA	<input type="checkbox"/>	<input type="checkbox"/>
			CCNRE	<input type="checkbox"/>	<input type="checkbox"/>

REMARKS:

There will be a Cabinet Council on Economic Affairs Planning Meeting today, January 31, at 2:00 P.M. in the Roosevelt Room.

The agenda and background paper for the second agenda item are attached.

Received too late

DCI
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RETURN TO:

☐ Craig L. Fuller

Assistant to the President

☐ Don Clarey☒ Tom Gibson☐ Larry Herbolzheimer

Associate Director

File L 300 B

THE WHITE HOUSE

WASHINGTON

January 30, 1985

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: ROGER B. PORTER *RBP*

SUBJECT: Agenda and Paper for the January 31 Meeting

The agenda and paper for the January 31 meeting of the Cabinet Council on Economic Affairs are attached. The meeting is scheduled for 2:00 p.m. in the Roosevelt Room. Attendance is limited to principals only.

The Council is scheduled to consider two agenda items: farm credit conditions and Export-Import Bank interest subsidies and OMB Circular A-70.

The Council will continue its review from yesterday's meeting on farm credit conditions. Papers outlining proposed revisions in the September 1984 Agricultural Debt Restructuring Initiative, six Farm Debt Management Initiatives, and a proposal to establish a Farm Credit Coordinating Group were circulated at yesterday's meeting. No further papers will be circulated on this agenda item in advance of the meeting.

The Council will also consider Export-Import Bank interest subsidies and OMB Circular A-70. The Eximbank has proposed providing a full guarantee for subsidized loans and financing them through the Private Export Funding Corporation (PEFCO). The attached memorandum reviews the advantages and disadvantages of the proposal versus financing subsidized export loans in accord with OMB Circular A-70.

Attachments

THE WHITE HOUSE
WASHINGTON

CABINET COUNCIL ON ECONOMIC AFFAIRS

January 31, 1985

8:45 a.m.

Roosevelt Room

AGENDA

1. Economic Impact of Farm Credit Conditions (CM#515)
2. Export-Import Bank Interest Subsidies and OMB Circular A-70 (CM#516)



DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

January 30, 1985

ASSISTANT SECRETARY

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: Thomas J. Healey *T-*

SUBJECT: Export Import Bank (Eximbank) Interest Subsidies
and OMB Circular A-70

This memorandum has been prepared for the discussion on Thursday, January 31, of the method to finance loans under the Eximbank interest rate subsidy program that is to replace the Eximbank's direct loan program in the FY 1986 Budget. While there is clear agreement on the interest rate subsidy concept, the financing method that is to be used to fund the new program needs to be reviewed in light of broader Federal credit policy concerns, particularly the consistency of the financing concept with Federal credit policies enunciated in the recently revised OMB Circular A-70, which was approved by the President and issued by David Stockman in August 1984.

The revised OMB Circular A-70 establishes more rigorous guidelines for Federal agencies to follow in administering existing credit programs and proposing legislation to establish new ones. Its purposes are to reduce the Government's cost of providing credit aids, to make the subsidies provided by credit programs more explicit in the Federal Budget and to curb the expansion in the use of Federal credit programs by making their terms more nearly reflective of terms on private financing.

In December the President approved discontinuing the Eximbank direct loan program in the FY 1986 Budget. It was subsequently agreed by OMB and Eximbank, with Budget Core Group approval, that authority would be proposed to allow Eximbank to use \$100 million (in present value terms), plus receipts from fees, to subsidize the interest rates on export-related borrowing. There was no discussion, however, of whether the subsidy would be available on guaranteed loans or whether loans financed through the Private Export Funding Corporation (PEFCO) would be eligible to receive subsidies. Eximbank has proposed providing a full guarantee for subsidized loans and financing them through PEFCO, which has raised a number of concerns. The Budget language is silent regarding whether loans would be fully guaranteed or financed through PEFCO. Thus, this memorandum presents options to clarify the financing question.

Option 1: Full guarantee of principal and interest with market financing by PEFCO.

The objective of providing a new program of interest subsidies to replace Eximbank direct loans is to maintain the competitiveness of US exports through below-market financing arrangements and to do so with a minimal initial impact on the Federal Budget. While the Federal Financing Bank (FFB) legally could provide the financing, if the loans were guaranteed, the budget-minimizing objective could not be attained, since the FY 1986 Budget also proposes to include FFB activity in budget outlays.

Pros:

-- A full guarantee and direct financing in the securities market (through PEFCO) would lower export financing costs relative to a partial guarantee.

-- Apparently some specific planning already has been done within the Eximbank with respect to the use of PEFCO's financing facilities.

-- Enable Eximbank to respond fully to foreign-subsidized competition, a key Congressional concern.

-- Would not change the current practice of a full guarantee for loans purchased by PEFCO (which previously were a small proportion of Eximbank activity).

-- Provides greatest assurance of smooth introduction of the new interest subsidy mechanism.

Cons:

-- Erosion of Credibility of the Budget and OMB Circular A-70. If a purpose of the \$50 billion budget cut in FY 1986 Budget is to reassure financial markets and enhance the credibility of the commitment to control spending, off-budget market financing for this program through PEFCO is likely to be counterproductive if a full guarantee is provided. Furthermore, this program will be the first new credit program legislative proposal to surface since Circular A-70 was revised in August. If the Administration proposes a deviation from A-70 in order to remove financing from the Budget, it will undermine future efforts to apply A-70 principles.

-- Establishment of Another Major Government-sponsored Agency. While PEFCO differs in many respects from FNMA, FHLMC, SLMA and the other sponsored agencies, it is similar in that it is privately-owned, off-budget, and Government supported. PEFCO has been an inconsequential market factor, with borrowings in FY 1984 of only \$100 million, but it would now be established as a major issuer of, in effect, Treasury-backed securities.

-- Expands Use of Eximbank Full Guarantee (PEFCO Terms). The only occasion on which Eximbank provides a full guarantee of interest and principal is when PEFCO is doing the financing, and such guarantees have accounted for only a small proportion of Eximbank programs. Eximbank usually provides only a partial guarantee of interest (Treasury 1-year rate, plus 1 percentage point) under its financial guarantee program.

-- Conflict with Treasury Debt Management. Treasury would be in the anomalous position of effectively guaranteeing PEFCO issues that would compete directly with Treasury issues in the market at higher rates. Given the current extraordinary demands of the Government on the financial markets, and thus the importance of coordinated debt management policies, this is an especially bad time to lose control over any significant portion of that borrowing.

Option 2: Finance the subsidized export loans in accord with OMB Circular A-70.

If loans are to be guaranteed, Circular A-70 would require private co-insurance equal to or greater than 20 percent of the credit risk stemming from default. This would preclude financing through PEFCO.

Pros:

-- No impetus would be given to expansion of PEFCO financing activity, and the overall Government risk exposure in this program would be less because of partial private participation.

-- The first new credit program legislation to be proposed after the August 1984 revisions in OMB Circular A-70 would be consistent with the credit program principles that it sets forth.

-- Eximbank's usual policies requiring private credit risk participation in guaranteed export loans would be preserved and strengthened.

Cons:

- The requirement of risk-sharing by private lenders would result in financing at higher commercial rates of interest, which would reduce the attractiveness of the financing terms for exports.
- Involves greater uncertainty about effectiveness in meeting foreign export competition.

Option 3: Phase in private credit risk exposure on guaranteed loans providing interest rate subsidies.

Instead of requiring private investors to assume 80 percent of the credit risk, as provided in Option 2, require private co-insurance of a lesser amount, for example 10 percent, of any credit risk related losses. This lesser degree of co-insurance would be provided for loans to which the first \$100 million of interest subsidy would apply with the understanding that the amount of co-insurance would increase if any further interest subsidy monies were authorized in the future.

Pros:

- Phasing in the degree of private co-insurance of loans under the new program would reinforce the Administration's commitment to the principles of Circular A-70, while at the same time recognizing that it will take time before loan guarantee programs generally will reach or exceed the 20-percent co-insurance goal.

Cons:

- Same as under Option 2 above, except that greater guarantee protection should lower the rate to the borrower.